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No. 93-719

In The

# Supreme Court of the United States

October Term, 1993

FIGGIE INTERNATIONAL, INC.,

*Petitioner,*

vs.

FEDERAL TRADE COMMISSION,

*Respondent.*

**On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit**

## PETITIONER'S REPLY TO BRIEF IN OPPOSITION

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1. **Petitioner's claim is properly before this Court.** The Commission contends that Petitioner, Figgie International, Inc. ("Petitioner" or "Figgie"), did not argue below that reckless conduct was required for Section 19(a)(2) liability. A fair reading of the briefs which Figgie filed in the court of appeals compels the conclusion that Figgie argued there precisely what it has argued here: more than mere negligence is required for establishing liability for consumer redress under section 19(a)(2) of the FTC Act.[1]

Quoting selectively and incompletely from Appellant's Opening Brief in the court of appeals, the Commission asserts that Figgie argued that "Section 19 requires proof that its practices were 'specifically intended to deceive and defraud consumers.' "[2] Brief For The Respondent In Opposition ("Opp. Br."), p. 14. The *full statement*, in context, actually reads:

> "Accordingly, Figgie contends that the 'reasonable man' standard of § 19(a)(2) cannot be regarded as providing for liability based on

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[1] Petitioner's Appendix to this Reply Brief, "Appendix B," includes relevant excerpts from all three of the briefs which Figgie filed in the court of appeals. The *original* page numbers of the brief are set forth in brackets preceding each page.

[2] We find the pervasive misleading statements in the Commission's brief to fall far short of the professionalism we have come to expect from those who represent the government in litigation. Having to make this comment regarding a brief filed by the Solicitor General is particularly disturbing and disappointing.

> mere *negligence*. Rather, the statute prescribes an *objective standard* for determining whether, *in fact*, the acts or practices in question were specifically intended to deceive and defraud consumers. Hence the issue is whether a reasonable man in Figgie's shoes *would have known* he was committing deliberate fraud."

App. B, B-4; emphasis in original. Even if one could argue that the above passage was ambiguous, no ambiguity remained after Figgie filed its Reply Brief. There, Figgie stated:

> "A fair reading of Figgie's opening brief will reveal that we did not argue that 'subjective intent' must be proved. Nor did we ever say that conduct violative of the mail fraud statute, or some other criminal statute, must be shown. We do indeed contend that a *specific intent to defraud* must be shown. In so doing, however, we acknowledge that an *objective* reasonable man standard is to be applied in determining whether such specific intent existed. [Appellant's Op.Br., pp. 34-35]
>
> "The Commission, on the other hand, appears to be suggesting that the standard for liability under § 19 is akin to mere *negligence*. [Appellee's Br., pp. 31, n. 24, 37] Figgie submits that that interpretation fails to give meaning to all of the words used in the statute. The terms "dishonest or fraudulent" necessarily connote an *intent* to deceive, as distinguished from the making of carelessly misleading statements. If negligence were the standard, virtually all § 5

> violations would warrant redress under § 19. That plainly is not what Congress intended."

App. B, B-5 to B-6; emphasis in original.[3]

Figgie clearly and consistently asserted the issue of the degree of scienter required for Section 19(a)(2) liability. Although Figgie did not apply the term "recklessness" to the degree of scienter it advocated, the above-cited excerpts plainly demonstrate that what Figgie advocated was tantamount to a recklessness scienter standard.[4] Moreover, while Figgie's Petition to this Court borrows definitions of "reckless conduct" from cases interpreting Section 10(b) of the Securities Act of 1934, other areas of the law, including tort law, could just as easily have been cited.[5]

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[3] That the court of appeals was, at best, confused or, at worst, misled by the Commission's tactics is apparent from the court's statement, "Figgie would have us construe 'reasonable person would have known' to require actual knowledge." App. A, A-14.

[4] In contrast, in the cases relied upon by the Commission, the parties failed to raise the *issue* in the lower courts. In *United States v. Lovasco*, 431 U.S. 783, 788 n.7 (1977), the government never raised at all the procedural issue that the district court should have deferred action on its motion to dismiss, and in *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 147 n.2 (1970) the petitioner never raised at all the issue concerning liquidated damages under Sections 1 and 2 of the Civil Rights Act of 1875.

[5] *See, e.g., Bilden v. United Equitable Insurance Company*, 921 F.2d 822 (8th Cir. 1990): the phrase "knew or should have known" imposes a recklessness standard. 921 F.2d at 828-29, n.7, citing Restatement (Second) of Torts § 500, comments f & g (1965). Section 500 of the Restatement (Second) of Torts provides: "The actor's conduct is in reckless disregard of the safety of another if he does an act or intentionally fails to do an act

2. **The consumer redress cases cited by the Petitioner apply a recklessness standard.** The Commission's treatment of *FTC v. Macmillan, Inc.*, 1983-2 Trade Cas. (CCH) ¶ 65,553 (N.D.Ill. 1983) and *FTC v. Glenn W. Turner*, 1983-1 Trade Cas. (CCH) ¶ 65,244 (M.D. Fla. 1982) is factually and legally inaccurate. The *Turner* court did *not* find the challenged scheme "unlawful under the criminal statute," and the *Macmillan* court did not "reject" Figgie's position.

In *Turner*, a Section 19(a)(2) case, the court applied the mail fraud standard for liability set forth in *Blachly v. United States*, 380 F.2d 665, 671 (5th Cir. 1967). *Macmillan* cited *Turner* then observed that, "[i]n employing the *Blachly* standard, the Seventh Circuit has required a showing of *specific intent* based on the conduct and state of mind of the defendant." 1983-2 Trade Cas. ¶ 65,553, at 68,756; emphasis added. *Macmillan* explained that the *Turner* standard for "dishonest or fraudulent" conduct, although requiring a showing of *specific* intent, "does not . . . [require] proof of a defendant's *actual* intent to defraud consumers." 1983-2 Trade Cas. ¶ 65,553, at 68,759; emphasis added. This is precisely what Figgie argued in the court below. *See*, App. B, B-1 to B-6.

Curiously, the Commission attempts to bolster its position by citing cases seeking injunctive relief under

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which it is his duty to the other to do, knowing or having reason to know of facts which would lead a reasonable man to realize, not only that his conduct creates an unreasonable risk of physical harm to another, but also that such risk is substantially greater than that which is necessary to make his conduct negligent."

Section 13(b) of the FTC Act, stating that "the courts have frequently applied Section 19 standards in determining whether to grant monetary equitable relief in such suits." Opp.Br., p. 15. But the very cases the Commission cites support Figgie's position. In *FTC v. Amy Travel*, 875 F.2d 564 (7th Cir. 1989), the court, relying on *FTC v. Kitco of Nevada, Inc.*, 612 F.Supp. 1282 (D.C. Minn. 1985), holds:

> "The FTC is required to establish the defendants had or should have had knowledge or awareness of the misrepresentations, *Kitco*, 612 F.Supp. at 1292, *but that knowledge requirement may be fulfilled by showing that the individual had 'actual knowledge of material misrepresentations, reckless indifference to the truth or falsity of such misrepresentations, or an awareness of a high probability of fraud along with an intentional avoidance of the truth.' Kitco*, 612 F.Supp. at 1292; *see also International Diamond*, 1983-2 Trade Cas. (CCH) at 69, 707."

875 F.2d at 574; emphasis added. *See, also, FTC v. Sharp*, 782 F.Supp. 1445, 1450 (D.Nevada 1991).

Although the Commission avoids taking a direct position on the issue, it is apparent that it advocates a negligence standard for Section 19(a) (2) liability.[6] Yet, try as it might to recast the cases which have been decided, the Commission cannot change the fact that prior to the Ninth Circuit's decision in this case, *no court* had determined that mere negligence is sufficient for consumer redress liability under Section 19.

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[6] *See, e.g.*, Opp.Br., p. 16, "even if it were appropriate to construe Section 19 of the FTC Act to incorporate a standard of liability more demanding than a negligence standard . . . "

**3. The Section 5 administrative proceeding did not determine that a reasonable person in Figgie's position would have known its actions were dishonest or fraudulent.** The Commission asserts, without a single citation to the record, that "the record amply supports the lower courts' conclusion that a reasonable person would have known that petitioner's conduct was dishonest or fraudulent" (Opp. Br., p. 16) and that "the Commission's administrative findings, upheld by the fourth Circuit . . . conclusively established what petitioner knew when it deceived consumers." *Id.* From these erroneous statements the Commission concludes that "the Commission's fact finding was dispositive of the reasonableness of petitioner's conduct and the 'dishonest or fraudulent' nature of its practices." Opp. Br., p. 12.

It is, and has been, Figgie's principal contention in this case that *summary judgment* was improperly granted solely on the basis of the Section 5 administrative findings, precisely because those findings did not determine – or even consider – whether Figgie knew or should have known that the challenged claims regarding its heat detectors were "dishonest or fraudulent." Figgie's *knowledge* simply was not a relevant consideration in the Section 5 proceeding. Neither the ALJ nor the Commission even remotely suggested that the representations ultimately found to be "deceptive" were also "dishonest or fraudulent," let alone that a reasonable person in Figgie's position "would have known" that fact *at the time the materials were disseminated.* Figgie continued to disseminate most of its challenged promotional materials during the Section 5 proceeding because it vigorously disputed the validity of the hypothetical "tenability limits" used in

certain tests and questioned the evaluations of heat detectors based on those tenability limits. Indeed, the Section 5 findings, as a whole, demonstrate that the so-called "scientific data" relied upon by the Commission generated substantial debate.

Of course, once the Commission's cease and desist order became final, Figgie was required to accept that result as conclusive, even though it still did not (and does not) agree that it is correct. Figgie never attempted to relitigate *that* issue. Rather, Figgie contended that the questionable, conflicting, and uncertain nature of the "scientific" evidence, before and during the administrative proceeding, was relevant in determining what a reasonable person in Figgie's position would have known *while Figgie was still challenging the test result in the Section 5 proceeding* and presented a triable issue of fact which should have precluded summary judgment in this case.

**4. Application of a "presumption" of consumer reliance effects an unjust result where no trial was conducted and not a single consumer testified regarding reliance.** The Commission's final argument again rebuts an argument which Figgie never made, either in this Court or the lower courts. Figgie has never contended that the Commission must prove that each and every consumer relied on Figgie's representations which were deemed deceptive in the Section 5 proceeding. Rather, Figgie has consistently argued that the Commission cannot properly obtain *summary judgment* awarding redress to all consumers without even showing actual reliance by one consumer.

The Commission, again citing Section 13 injunction cases, contends that a "presumption of reliance" was sufficient for the court to grant summary judgment in its favor, even though not a single consumer testified that he or she had relied on the challenged representations or was misled by them. Even the cases cited by the Commission do not go so far. *FTC v. Security Rare Coin & Bullion Corp.*, 931 F.2d 1312 (8th Cir. 1991), *Amy Travel, supra, Kitco of Nevada, supra,* and *FTC v. Atlantex Assocs.*, 1987-2 Trade Cas. (CCH) ¶67,788, were all cases decided *after trials* where evidence was taken and consumers testified. *See, e.g., Atlantex,* 1987-2 Trade Cas. (CCH) 67,788, at 59, 251; *Amy Travel,* 875 F.2d at 570.

While it may indeed be "virtually impossible" for the Commission to offer individualized proof that all, or even most, consumers relied on the challenged representations, it is most certainly contrary to the legislative purpose and clear language of the statute to permit the Commission to satisfy the reliance and injury requirements and obtain a judgment for $49,950,000, without trial, based *solely* on a presumption which has never been applied in a Section 19 case. The unfairness is especially egregious here, where the "presumption" was based on a mere inference which itself could not have justified summary judgment.[7]

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[7] The *only* evidentiary support cited was the fact that Figgie's sales materials advocated the purchase of four or five heat detectors per smoke detector, and that matched Figgie's sales ratio. App. A, A-20. But the section 5 findings also show that some of Figgie's promotional claims were true, and that heat detectors provide added protection over smoke detectors alone. App. A, A-142. Indeed, Figgie's sales ratio was consistent with

Moreover, once such a "presumption" was accepted by the district court, Figgie had a burden which was not only difficult, but impossible to satisfy: it was charged with negating the presumption by showing individual non-reliance. While such burden shifting may be fair and just in a Section 13(b) case, since "Congress intended Section 13(b) to be limited to garden variety fraudulent acts and practices" (*FTC v. International Diamond Corp., supra,* 1983-2 Trade Cas. (CCH) at 69,706), it can have calamitous results in a Section 19 case, particularly if the Commission is permitted to establish liability based solely on findings made in a Section 5 proceeding, where what the defendant knew or should have known was never determined, and actual consumer reliance was not established.

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the recommendations of the National Fire Protection Association set forth in NFPA Standard 74 (1980 ed.) for most single story residences. App. A, A-137, A-189. Hence, it cannot be said that the only reasonable inference to be drawn from the record is that all consumers must necessarily have been deceived by Figgie.

## CONCLUSION

The Petition for Certiorari should be granted to ensure that the Ninth Circuit's clearly erroneous interpretation of Section 19(a)(2) of the Federal Trade Commission Act is not perpetuated in the lower courts.

Respectfully submitted,

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## APPENDIX B

## EXCERPT FROM APPELLANT'S OPENING BRIEF FILED AND SERVED AUGUST 30, 1991

[p. 33] II. THE DISTRICT COURT ERRED IN GRANTING SUMMARY JUDGMENT ON THE ISSUE OF LIABILITY

A. The Statutory Requirements For Figgie's Liability.

It is apparent from the express language of §§5 and 19, that the remedy of consumer redress in §19 is not automatically available to the Commission merely because it has issued a cease and desist order finding that some act or practice is "unfair or deceptive." Section 5(b) empowers the Commission to issue a cease and desist order, "[i]f upon such [evidentiary] hearing, the Commission *shall be of the opinion*" that an act or practice is prohibited by the statute. (Emphasis added) In other words, the law gives the Commission the last word on that issue.[19]

If the Commission does seek consumer redress under §19 after a cease and desist order has become final, its determination that the act or practice was "unfair or deceptive" is binding on the court, along with all of the Commission's findings "as to the material facts" in the §5

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[19] As the Commission itself said in issuing the cease and desist order against Figgie, it will find a representation to be "deceptive" if it is "likely to mislead consumers" who reasonably interpret it. But the Commission acknowledged that in making that determination, "[o]ur deception analysis focuses on the risk of consumer harm; *actual injury to consumers need not be proved.*" (Emphasis added) [Com. Op., pp. 373-374]

proceeding. Section 19(c).[20] But §19(a)(2) establishes the following additional element as the staturoy [sic] prerequisite for entitlement to relief:

> "If the Commission satisfies the court that the act or practice to which the cease and desist order relates is one which a reasonable man would have [p. 34] known under the circumstances was dishonest or fraudulent, the court may grant relief under subsection (b) of this section."

On its face, this language gives *the court sole responsibility for deciding* whether a reasonable man would have known under the circumstances that the subject act or practice was "dishonest or fraudulent." This plainly means that a representation found to be "unfair or deceptive" under §5 is not necessarily "dishonest or fraudulent" within the meaning of §19. Moreover, even if the Commission had purported to go beyond the requirements for a cease and desist order and had specifically found that the representations under scrutiny were "dishonest or fraudulent" (which it didn't), that finding could not be binding on the court under §19(c) – first, because it would not be a "material finding" in the §5 proceeding,

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[20] The only review of the correctness of the Commission's material findings is by appeal from the cease and desist order directly to the court of appeals. There, however, the court of appeals is required to affirm the order "as long as it is supported by sufficient evidence to permit a reasonable mind to accept the Commission's conclusion." *Amrep Corp. v. FTC*, 768 F.2d 1171, 1179 (10th Cir. 1985) In the instant case, the Commission's cease and desist order was affirmed by the fourth circuit, without a published opinion. *Figgie International v. FTC*, 817 F.2d 102 (4th Cir. 1987).

and second, because *de novo judicial review* on the issue of *scienter* is required in any event. Otherwise, the "satisfies the court" language of §19(a)(2) would be meaningless.

The term "dishonest or fraudulent" is not defined in §19. Although the statute was adopted in January 1975, only a few reported cases have been brought under it. In *FTC v. Turner,* 1983-1 Trade Cases ¶65,244 (M.D. Fla. 1982), at p. 69,451, the court concluded:

> "Acts which are fraudulent or dishonest for purposes of consumer redress should fall at least within the scope of the activities which would be deemed fraudulent for purposes of the mail fraud statute, 18 U.S.C. §1341. Acts within the purview of that statute need only be reasonably calculated to deceive persons of ordinary prudence and comprehension. See *Blachly v. United States,* 380 F.2d 665 (5th Cir. 1967)."

This analogy to the mail fraud statute was accepted in two later §19 cases, *FTC v. MacMillan Inc.,* 1983-2 Trade Cases, ¶65,553, at p. 68,756 (N.D. Ill. 1983), and *FTC v. Amrep Corp.,* 705 F.Supp. 119, 127 (S.D.N.Y. 1988). *MacMillan* added the following, however:

> [p. 35] "In employing the *Blachly* standard, the Seventh Circuit has required a showing of specific intent based on the conduct and state of mind of the defendant (citation)."

Likewise, *this Court* requires as one of the elements of a violation of the mail fraud statute, a showing that the defendants had "the specific intent to deceive or defraud." *Schreiber Dist. v. Serv-Well Furniture Co.,* 806 F.2d 1393, 1399-1400 (9th Cir. 1986); *United States v. Bohonus,* 628 F.2d 1167, 1172 (9th Cir. 1980).

Accordingly, Figgie contends that the "reasonable man" standard of §19(a)(2) cannot be regarded as providing for liability based on mere *negligence.* Rather, the statute prescribes an *objective standard* for determining whether, *in fact,* the acts or practices in question were *specifically intended to deceive and defraud consumers.* Hence, the issue is whether a reasonable man in Figgie's shoes *would have known* he was committing deliberate fraud.[21]

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[21] Kanwit, Federal Trade Commission: Regulatory Manual, Vol. 2, §21.03, pp. 21-10 to 21-11, interprets the *scienter* requirement of §19(a)(2) as follows:

> "While the section puts intent or state of mind of the respondent at issue as does the mens rea element of criminal offenses, the Conference Report states that the court need not find that an act or practice rises to the level of a criminal violation to order redress. The test basically protects business from substantial liability for novel or technical interpretations of FTCA §5(a) and ensures that respondent knew, or should have known, that the conduct by its very nature was wrong. *Thus, a business person acting in good faith at the time an act or practice is committed will probably not be liable for redress under the §19(a)(2) standard."* (Emphasis added.)

**EXCERPT FROM APPELLANT'S REPLY BRIEF FILED AND SERVED NOVEMBER 25, 1991**

[p. 13] C. The Commission's Argument That It Is Not Required To Show Figgie's Specific Intent To Defraud Is Wrong

The Commission's brief argues at considerable length that the district court correctly determined it was not required to show Figgie specifically intended to defraud consumers. [Appellee's Br., pp. 22, 30-37] In so doing, however, the Commission misstates Figgie's position, and wastes most of its ammunition on strawmen.

Thus, the Commission wrongly attributes to Figgie a contention to the effect that the Commission was required to prove a "subjective intent to defraud." [Appellee's Br., pp. 22, 32] This enables the Commission to argue, "Figgie has not advanced any reason why this Court should abandon the objective 'reasonable man' standard." [Appellee's Br., p. 31] Similarly, the commission suggests that Figgie has argued that the statute requires proof of "criminal fraud." The Commission responds to that strawman by referring to the legislative history of § 19, and to the well known maxim that all of the words used in a statute must be given meaning. [Appellee's Br., pp. 31-36]

A fair reading of Figgie's opening brief will reveal that we did not argue that "subjective intent" must be proved. Nor did we ever say that conduct violative of the mail fraud statute, or some other criminal statute, must be shown. We do indeed contend that a *specific intent to defraud* must be shown. In so doing, however, we acknowledge that an *objective* reasonable man standard is

to be applied in determining whether such specific intent existed. [Appellant's Op. Br., pp. 34-35]

The Commission, on the other hand, appears to be suggesting that the standard for liability under § 19 is akin to mere *negligence*. [Appellee's Br., pp. 31, n. 24, 37] Figgie submits that that interpretation fails to give meaning to all of the words used in the statute. The terms "dishonest or fraudulent" necessarily connote an *intent* to deceive, as distinguished from the making of carelessly misleading statements. If negligence were the standard, virtually all § 5 violations would warrant redress under § 19. That plainly is not what Congress intended.

**EXCERPT FROM APPELLANT'S PETITION FOR REHEARING AND SUGGESTION OF APPROPRIATENESS FOR REHEARING EN BANC FILED AND SERVED MAY 21, 1993**

[p. 14] III. THE COURT ERRONEOUSLY CONCLUDED THAT NO TRIAL WAS NEEDED ON THE ISSUE OF SCIENTER UNDER SECTION 19.

Neither the ALJ nor the FTC purported to find in the § 5 proceeding that the deceptive representations which they gleaned from Figgie's promotional materials were "dishonest or fraudulent" within the meaning of § 19, let alone that a reasonable person in Figgie's position "would have known" that fact when the materials were disseminated. Indeed, such findings would have been irrelevant in a § 5 proceeding.

Because of the differences in the two statutes, it would seem unlikely except in the most obvious and egregious cases of fraud that § 5 findings would be enough to eliminate the need for a trial on the additional element of scienter for § 19 purposes. This most certainly was not such a case. In other kinds of cases, this Circuit has recognized that summary judgment generally is inappropriate where liability depends upon a finding [p. 15] a state of mind or reasonableness of conduct. *Braxton-Secret v. A.H. Robbins Co.*, 769 F.2d 528, 531 (9th Cir. 1985); *Okada v. MGIC Indem. Corp.*, 795 F.2d 1450, 1456 (9th Cir. 1986); *Commodity Futures Trading Commission v. Savage*, 611 F.2d 270, 282-284 (9th Cir. 1979). This case should have been governed by that principle.

The page limitation for this petition does not permit a discussion of the many reasons why the court misconstrued the § 5 findings as being sufficient to conclusively establish Figgie's scienter under the § 19 standard, but one significant point involves the court's misreading of NFPA 74, discussed *supra* in § IIB. This court wrongly assumed that Figgie's continued promotion of a combined system having more heat detectors than smoke detectors was fraudulent in light of the changes in NFPA 74 after the two fire tests mentioned. (Op., p. 4522) As we have shown, the combined system Figgie promoted was not inconsistent with the changed rules.

As one last point, we refer the court to our briefs discussing Figgie's use of a 117° fuse instead of the 136° fuse used in the Dunes and Cal Chief's tests, and the 1983 test by the San Francisco Fire Department where the 117° fuse and a 200° heat tenability limit were used. (Open. Br., pp. 19, n. 14, 21; Reply Br., p. 6, n. 3) Although these facts gave Figgie a reasonable basis for continuing to dispute the earlier tests until the FTC's cease and desist order became final, they are not even mentioned in the court's opinion.

Dated: May 21, 1993.

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